

INSURERS AND SOCIETY: OPPORTUNITIES AND CHALLENGES IN THE PERIOD TO 2030

A report from the Economist Intelligence Unit.



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Preface

Insurers and Society is an Economist Intelligence Unit report, sponsored by BNY Mellon. The findings and views expressed in the report do not necessarily reflect the views of the sponsor. The author was Gill Wadsworth and the editor was Monica Woodley.

About the research

In December 2012 the Economist Intelligence Unit surveyed 332 companies around the world. Respondents comprise 164 insurers from life, non-life and reinsurance companies and 168 intermediaries, including financial advisers, wealth managers and private banks. Respondents were grouped into three regions: North America with 100 individuals; Europe with 115; and Asia with 117.

The survey data is augmented with eight in-depth interviews and our thanks are due to:

- Steven Brostoff, senior spokesman at the American Council of Life Insurers
- Jim Donelon, president of the National Association of Insurance Commissioners and Louisiana Insurance Commissioner
- John Godfrey, director of corporate communications at Legal & General
- Mitch Hopkinson, UK managing partner at deVere Group
- Olav Jones, deputy director-general at Insurance Europe
- Carlos Montalvo, executive director at the European Insurance and Occupational Pensions Authority
- Takashi Okuma, general manager in the international department of the General Insurance Association of Japan
- Martin Senn, CEO of Zurich Insurance Group

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Executive summary

Despite surviving the global financial crisis with their reputations intact, insurance companies still have not enjoyed an easy ride during the testing economic conditions since 2008.

Ongoing macroeconomic uncertainty alongside proposed tough new regulatory regimes, natural disasters and extreme weather conditions, in addition to a combination of rising longevity and low investment returns, have all served to create very real challenges for the insurance industry.

In response, insurers are rethinking business processes and product ranges in order to remain competitive under new risk-based capital regimes, to meet the evolving needs of their customer base and to continue to play a beneficial role in the economy and broader society. However, insurers are finding it difficult to re-think too much of their strategy when much regulation, such as Solvency II, is still very much a moving target.

The Economist Intelligence Unit, on behalf of BNY Mellon, surveyed 332 companies around the world including insurers, reinsurers, wealth managers and independent financial advisers to find out what immediate and long-term challenges the insurance industry faces and how insurers are responding, as well as to explore

ways in which the industry will develop in the future. The survey results were supplemented with in-depth interviews with a range of experts.

The key findings of the research are:

- **Macroeconomic uncertainty, regulation and risk of contagion are the biggest challenges facing insurers in the long term**

Macroeconomic uncertainty is seen by survey respondents as the main challenge facing both life and non-life insurers (36% and 39% respectively) in the period to 2030. Regulation is the second-biggest challenge facing life insurers (34%), while risk of contagion from other parts of the financial system is a major concern for non-life insurers and reinsurers (33%).

- **Regulators and policymakers should consider socioeconomic goals**

Almost fourth-fifths (79%) of respondents agree that regulators should balance concerns for policyholder protection with other socioeconomic objectives, such as promoting savings, while almost one-half (48%) believe that policymakers should incorporate socioeconomic goals into regulators' remits. Over one-half (54%) of those surveyed believe that regulators and legislators are focusing on near-term stability at the expense of longer-term economic growth.

- **Insurers are not doing enough to meet societal responsibilities**

A strong majority (80%) of respondents agree that insurers have a duty to contribute positively to society, with all regions in equal agreement, yet only 55% agree that insurers are fulfilling that role. Overall, intermediaries are slightly less convinced that insurers are contributing (53%, compared with 56% of insurers), with the biggest discrepancy between the two groups seen in North America, where 64% of insurers believe that they are meeting their societal responsibilities, while just 36% of intermediaries agree.

- **Regulation is hampering insurers' ability to meet consumers' needs**

Almost three-quarters (70%) of respondents agree that individuals will have inadequate private savings and pensions as a long-term consequence of new regulation, while just over one-half (51%) believe that current regulatory and accounting rules encourage insurers to move away from guaranteed products, leaving individuals with the burden of investment risk. In response to changes affecting the industry, life insurers are offering fewer products (49%), limiting guarantees (40%) and raising prices (35%).

- **Insurers are needed more than ever but are at risk of irrelevance**

Over one-half of respondents (54%) believe that

regulation reduces insurers' ability to shift risk away from households and transform financial market risk into reliable streams of retirement income and other benefits—one of the industry's core functions. The same proportion believe that the burden will fall on governments to make up for individuals' private pension shortfalls, but many (45%) worry that they will not be able to afford to do so. Limiting the insurance industry's ability to transform risk will have serious ramifications for future generations and for the industry itself.

- **Insurers need help to support developing countries and emerging economies**

Nearly one-half (45%) of respondents said that supranational organisations should work with developing countries to inform policymakers better of the value of catastrophe and other forms of insurance as a top priority. Over one-half worry that without adequate data, reinsurers may withdraw from providing catastrophe reinsurance in emerging markets (55%), and that if reinsurers pull back from these markets, individuals and corporates will be forced to go underinsured (52%). Respondents (57%) also fear that the absence of reinsurance will slow investment into emerging economies, which in turn will slow these countries' economic growth—a major concern, given the importance of emerging economies to pulling the global economy out of stagnation.

Introduction

Insurers around the world face a succession of challenges as they begin 2013. Ongoing economic uncertainty alongside the significant costs of insuring against extreme weather events, shifting demographics and looming regulatory changes are converging to put significant pressure on the insurance industry.

At the same time, individuals and institutions are struggling with those same economic uncertainties and environmental threats, and are in greater need of the protection available from insurers than ever before.

In order to meet this consumer need while adhering to stringent regulatory requirements and maintaining their place as vital, positive contributors to capital markets and to society at large, insurers recognise the need to adapt and evolve their organisations.

However, there are some contradictions between what the industry believes that it should do best to manage current challenges and the steps that it is actually taking. Equally, there is the need for more collaboration and communication between insurers, supranational organisations and international and domestic regulators to help to manage immediate and long-term challenges. This includes marketing the benefits of insurance to consumers so that they recognise their own protection needs, as well as the insurance industry's contribution to wider societal goals such as economic growth.

In this report we explore the main challenges identified by the insurance industry and the ways in which it has responded, and examine what else can be done to help insurers to continue to drive positive economic behaviour while protecting society from risk. ■

1

Key challenges

The top challenges facing the life insurance sector in the years to 2030 are macroeconomic uncertainty, regulation, rising longevity and low investment returns.

When looking across the regions, the biggest issue for European life insurers is regulation. One-half of respondents located in Europe feel that regulation is a major threat to their organisations, which reflects the impact of risk-

based capital demands in the shape of Solvency II, the EU directive.

On the whole, insurers are supportive of Solvency II, which is designed to improve risk management, transparency and reporting and to align better capital requirements with underlying risks, with a view to providing more security to policyholders. However, a number of concerns remain.

Martin Senn, CEO of global insurer Zurich Insurance Group, says: “Insurers must be well capitalised but regulators must avoid setting overly conservative and detailed requirements. This could lead to an inefficient use of capital and ultimately more expensive prices for our customers. Solvency II must not become a bureaucratic and costly compliance exercise.”

For some insurers, the preparations for Solvency II are already costing significant sums and the continued uncertainty over the final shape of the regulation and its implementation date are problematic. And, although the regulation will create a more level playing field across Europe, the shift from current regulations—and hence the implications—are significantly bigger for some jurisdictions than others.

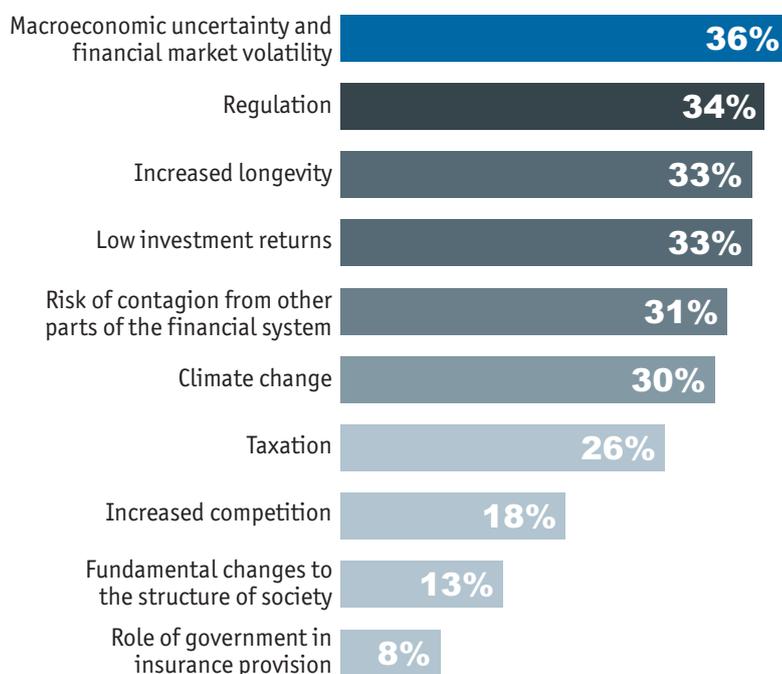
John Godfrey, director of corporate communications at UK-based insurer Legal & General (L&G), says: “[The] lack of regulatory certainty and frequent changes force insurers to invest heavily in projects like Solvency II. Several billion has been invested already, with no ultimate clarity emerging. The costs are ultimately borne by consumers.”

Chart 1



What do you believe are the factors most likely to affect the life insurance industry in the years to 2030?

(% respondents)



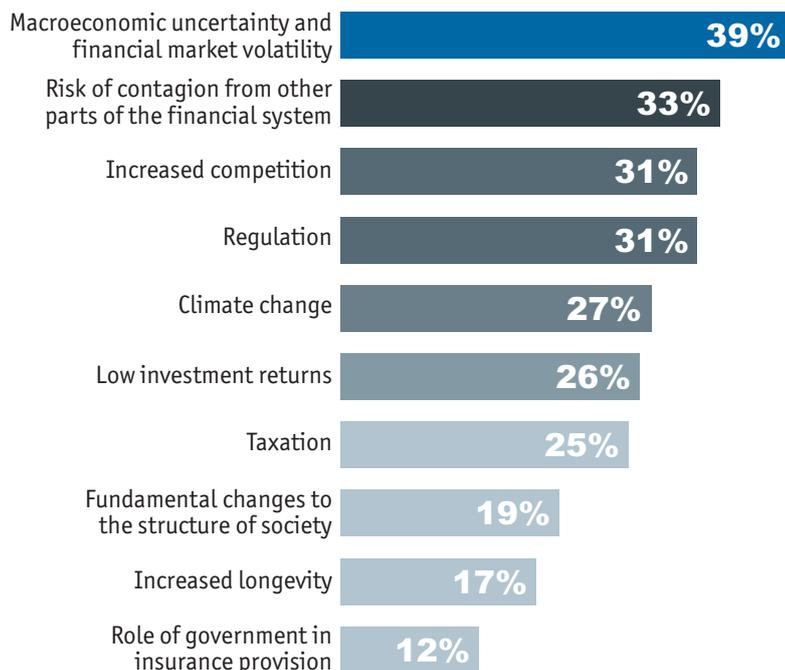
Note. Figures do not add to 100% as respondents could select up to three factors.
Source: Economist Intelligence Unit.

Chart 2



What do you believe are the factors most likely to affect the non-life/reinsurance industry in the years to 2030?

(% respondents)



Note. Figures do not add to 100% as respondents could select up to three factors.
Source: Economist Intelligence Unit.

And Solvency II is not the only piece of legislation on insurers' regulatory agenda. Olav Jones, deputy director-general of a European insurance trade body, Insurance Europe, says that companies are tackling numerous pieces of legislation simultaneously. The European Commission and EIOPA have an ambitious regulatory programme," he says. "As well as Solvency II there is the work to identify institutions that could potentially pose systemic risk to the economy; the EC upcoming Green paper on long-term investments; the review of the EU IORP Directive and more."

For non-life insurers and reinsurers, respondents also pointed to macroeconomic uncertainty as the biggest risk.

Zurich's Mr Senn says: "This uncertainty—particularly in the low interest rate environment, the risk of future inflation and the turbulences in the euro zone—has the potential to influence our overall strategy and the types of solutions we develop for our customers."

The insurance industry must also battle with the reputational fallout from the 2008/09 global financial crisis. Although their reputations were relatively untarnished in the wake of the credit crunch, insurers' proximity to and relations with the rest of the financial sector create some concern about "guilt by association". Consequently, almost three-quarters (73%) of respondents believe that insurance is at risk of contagion from problems in other parts of the financial system.

Further, the damage done to the financial markets following the economic meltdown from 2008 has led to a series of market shocks which have, in turn, damaged insurers' own investments and their ability to generate returns. Reflecting this, nearly three-quarters of respondents say that the insurance industry is still at risk of contagion, despite risk-based regulation.

Mitch Hopkinson, UK managing partner at a global independent financial adviser, deVere Group, says that insurers could have done more to make clear their lack of culpability during the crisis. "Insurers have not necessarily done enough to say 'we haven't created this issue'," he notes. "They have let life pass them by rather than stepping up and saying they weren't to blame and they do have an important role to play."

2 An insurer's role in society

Insurance was born out of the need to help individuals and institutions to protect themselves from risk, and survey respondents still consider this to be the most important way in which the industry contributes to society.

According to Insurance Europe's Mr Jones: "Protecting people from risks and enabling them to invest and save for their future are vital parts of the function of insurance to society. If someone is flooded and they are not insured then the impact is devastating, but if they are insured it can be emotionally painful and inconvenient but it becomes manageable."

Insurers also drive societal benefit through contributions to economic growth. Statistics from the UK's insurance trade body, the Association of British Insurers (ABI), show that in 2011 British insurers managed investments amounting to 26% of the UK's total net worth, employed 290,000 people and paid £10.4bn (US\$16.6bn) in taxes.

Insurers are also major investors both at home and abroad, which drives global economic growth. In the US, for example, the insurance industry is the biggest investor in US corporate bonds, which the American Council of Life Insurers (ACLI) describes as "the seed corn of business growth and job creation".

As large publicly listed companies, insurers also have a role in driving financial gain for their shareholders, and 60% of survey respondents agree that it is the duty of insurers to deliver returns to their investors. North American insurers felt most beholden to shareholders, with 66% believing that it is their duty to deliver value, while 61% of Asian insurers and 56% of European insurers felt the same.

Although satisfying shareholders and policyholders is clearly the highest priority for insurers, they must also meet other important responsibilities in their role as major investors; more than one-quarter (30%) of survey respondents say that insurers should act responsibly as shareholders of corporations, while just over one-third (34%) say that it is important to act responsibly as providers of debt and equity capital to corporations.

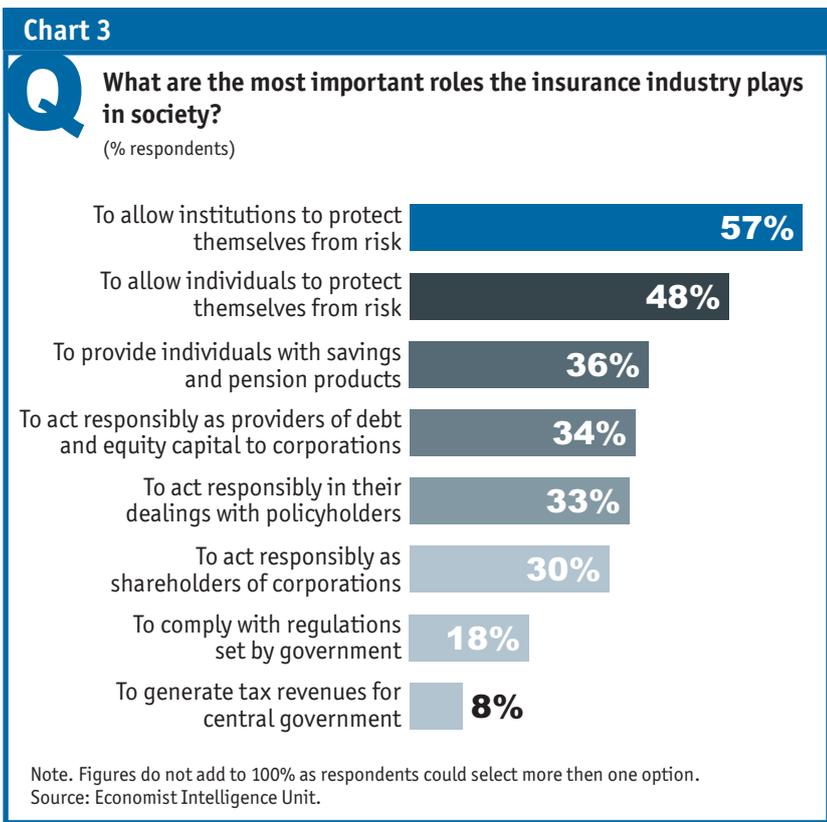


Chart 4

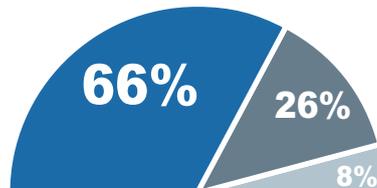


Do you agree or disagree with the following statements?

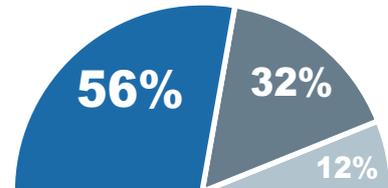
(% respondents)

● Agree ● Neither agree nor disagree ● Disagree

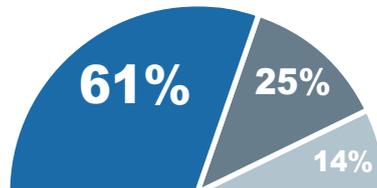
It is the duty of insurers to deliver returns to shareholders



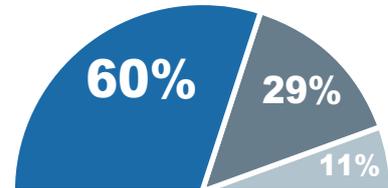
North America



Europe

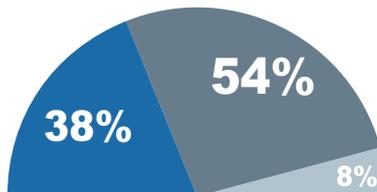


Asia

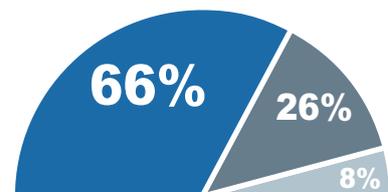


Overall

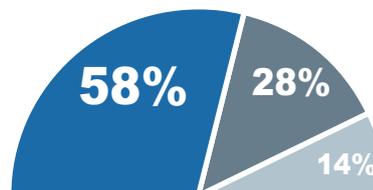
It is the duty of insurers to provide financial stability to policy holders/customers



North American insurers



European insurers



Asian insurers

Source: Economist Intelligence Unit.

Over one-half (57%) of respondents agree that it is the duty of insurers to provide financial stability to policyholders and customers.

Some 80% of all respondents agree that insurers have a duty to contribute positively to society, with all regions in equal agreement, and with

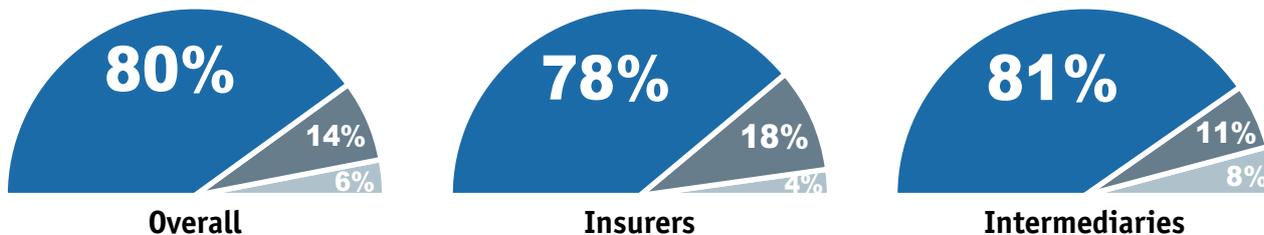
intermediaries marginally more likely to agree than insurers (81% versus 78%).

Jim Donelon, president of the National Association of Insurance Commissioners (NAIC) and Louisiana Insurance Commissioner, says: "The entire business model is about helping

Chart 5

Q Do you agree or disagree with the following statement?
It is the duty of insurers to contribute positively to society
(% respondents)

● Agree ● Neither agree nor disagree ● Disagree



Source: Economist Intelligence Unit.

society cope with the risks faced every day. Insurers are often cited for being good corporate citizens. In the aftermath of the recent Superstorm Sandy in the north-eastern part of the US, many insurers contributed substantial funds in support of first responder and charitable organisations serving the people displaced from homes and businesses.”

However, just 55% of respondents believe that insurers are contributing positively to society, which is a notable fall from last year’s survey of European insurers, which found that 69% of those surveyed agreed that insurers made a positive contribution. In addition, more than two-fifths (43%) agree that insurers need to go no further in contributing to society than complying with laws and regulations, representing only a marginal increase compared with last year’s European survey, in which 41% were in agreement.

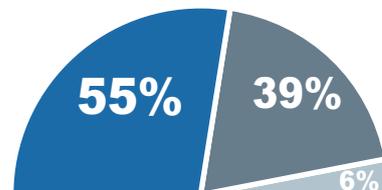
L&G’s Mr Godfrey suggests that insurers could better help society and consumers by allowing marginalised groups access to insurance products. “More could be done by widening access to insurance products for traditionally hard-to-reach groups, for example contents insurance for occupants of social housing,” he says. “Insurance should be an ‘everyman product’ and this has implications for product design and distribution/access.”

Meanwhile, Mr Hopkinson of deVere Group says: “Insurers could do more to reinvent themselves and create more presentable and more innovative products.”

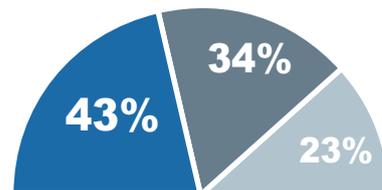
Chart 6

Q Do you agree or disagree with the following statements?
(% respondents)

● Agree ● Neither agree/ nor disagree ● Disagree



The insurance industry generally contributes positively to society



It is the duty of insurers to comply with all applicable laws and regulations, but beyond that, they have no duty to contribute positively to society

Source: Economist Intelligence Unit.

3 Regulatory impact

Insurers recognise the importance of sound regulation in driving good practice and promoting consumer confidence, yet the survey reveals a number of misgivings about the way that regulation is developing.

On the positive side, nearly one-half (46%) of respondents believe that risk-based capital systems are making policyholders more secure,

while 79% of those surveyed agree that regulation will renew consumer confidence in the insurance industry, which will, in turn, increase sales of insurance products.

However, 70% of all respondents believe that individuals will have inadequate private savings and pensions as a long-term consequence of new regulation, while more than one-half (51%)

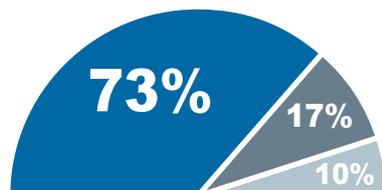
Chart 7



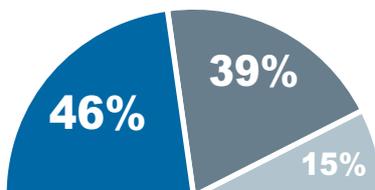
Do you agree or disagree with the following statements?

(% respondents)

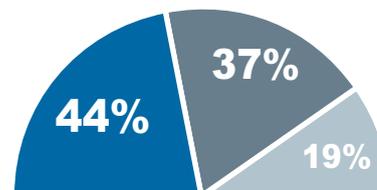
● Agree ● Neither agree nor disagree ● Disagree



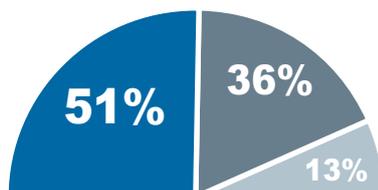
Despite regulation, insurers are still at risk of contagion from problems in other parts of the financial system



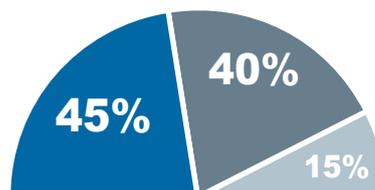
New regulation, specifically the move to risk-based capital regimes, has made policyholders more secure



Risk-based capital regimes will force insurers out of debt and equity capital markets and into holdings of sovereign debt and cash

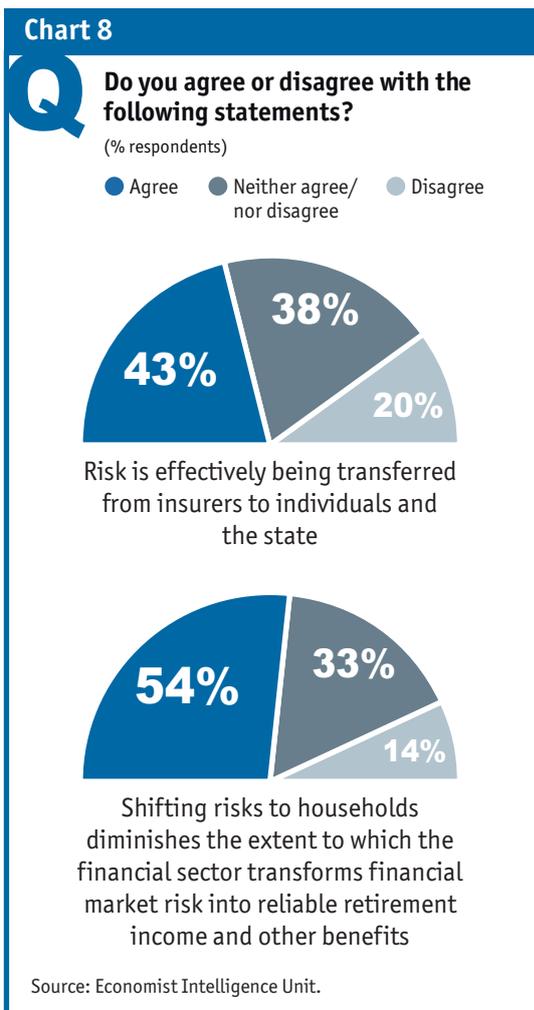


Risk-based capital regimes make it more likely that life or pension products will actually deliver what retail customers want, such as adequate pension or annuity streams



Regulation will ultimately drive insurers to less controlled jurisdictions as customers will not meet the associated costs

Source: Economist Intelligence Unit.



agree that the current regulatory and accounting rules encourage insurers to move away from guaranteed products, leaving individuals with the burden of investment risk.

Further, nearly two-fifths (39%) of all insurers and nearly one-half (46%) of intermediaries agree that risk is being transferred from insurers to individuals and the state, and more than one-half (54%) of all respondents agree that this shifting risk diminishes the extent to which the financial sector transforms financial market risk into reliable retirement income and other benefits. (Although it is possible that the introduction of risk-based capital regimes has simply turned implicit protection into explicit protection, albeit accompanied by greater costs and reduced flexibility.)

New regulation is designed to make policyholders more secure and confident, but insurers and intermediaries see the negative effects—that regulation will transfer risk to consumers and limit products—which consumers, perhaps, do not.

Mr Godfrey says: “Having appropriate, clear, proportionate and stable regulation—both prudential and conduct—can help consumer confidence and encourage consumers to protect themselves. Sadly, much regulation falls short of these ideals. One area where regulation can help is in supporting the insurers’ role as long-term investors, actively engaged in supporting the corporate governance agenda.”

Further concern lies in the application of regulation designed for other financial institutions, such as banks, to the insurance industry. Some insurance companies believe that attempting to adhere to legislation that does not work with the nuances of insurance may be to the detriment of consumers in the long term.

Zurich’s Mr Senn says: “Regulation must be tailored to the specific features of the insurance business model. It is crucial that regulation does not hinder insurers in fulfilling their economic role. For example, if rules designed for banks to address systemic risk were applied to insurers, this would reduce the ability of insurers to provide a range of solutions to customers, including large and small corporates and individuals. The amount of capital insurers hold should be determined by the nature of the underlying risks.”

The regulators, however, are keen to iterate that risk-based capital regimes force insurers to understand better the risks facing their organisations and, consequently, better manage them.

Carlos Montalvo, executive director at the European Insurance and Occupational Pensions

Authority (EIOPA), which is overseeing the implementation of Solvency II, says: “The objective of Solvency II is to encourage companies to better understand their risks. This understanding will allow insurers to properly identify, price and mitigate the risks they face and, therefore, make better decisions. This is positive to consumers.”

In the US, too, insurers are concerned about whether regulation is providing greater security to consumers. Just 38% of North American insurers and 36% of the region’s intermediaries agree that new regulation has made policyholders more secure. Further, more than one-half (58%) of North American insurers agree that new insurance regulations will starve corporates of debt and equity capital, rendering them unable to drive an economic recovery.

Steven Brostoff, senior spokesman at the ACLI, says: “Regulation is still in flux. [We] have argued repeatedly for capital rules that reflect [the] business model of life insurers, rather than the business model of banks. We are also concerned that Dodd-Frank [Wall Street Reform and Consumer Protection Act] regulations under development at federal regulatory agencies respect the statutory language granting insurance an exception to the Volcker Rule [which bans proprietary trading] and other measures.”

However, US regulators counter that insurers “know and are comfortable with the status quo”, and are unsettled by change, particularly where that change is uncertain. As a consequence, the NAIC’s Mr Donelon says that US regulators “have a lot of work to do to implement necessary changes.”

4

Staying relevant on the route to 2030

Given the high level of expectation that new regulation will lead to a weakening in insurers' ability to provide adequate pension savings, more than one-half (54%) of respondents believe that it will fall to governments to make up for individuals' private pension shortfalls. At the same time, 45% of respondents agree that governments will not be able to afford to make up these shortfalls, and this is a greater concern in Asia-Pacific, where one-half of respondents agree, compared with 44% in Europe and 40% in North America.

This suggests that insurers believe that their core competence—turning financial risk into reliable income streams—is being undermined by regulation, given that under proposed rules they are less able to take on that role.

Such a situation creates a vicious circle in which individuals underinvest for their future and are forced to rely on the government. In turn, governments cannot afford to bear the burden and are driven to the brink of bankruptcy, which devalues their sovereign debt. This then undermines proposed solvency regulation, which encourages insurers to hold government bonds as these are considered "risk free".

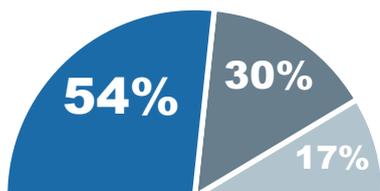
Chart 9



Do you agree or disagree with the following statement?

It will fall to individual nation states to make up for individuals' private pension shortfalls
(% respondents)

● Agree ● Neither agree/nor disagree ● Disagree



Source: Economist Intelligence Unit.

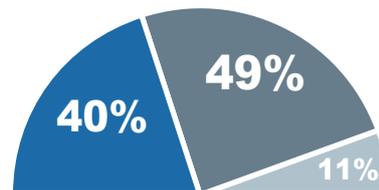
Chart 10



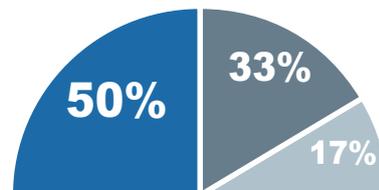
Do you agree or disagree with the following statement?

Nation states will not be able to afford to make up any private-sector pension shortfalls
(% respondents)

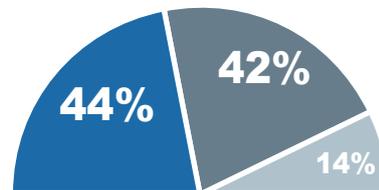
● Agree ● Neither agree nor disagree ● Disagree



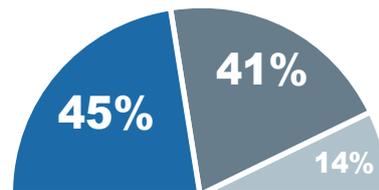
North America



Asia



Europe



Overall

Source: Economist Intelligence Unit.

The ultimate outcome of this unintended regulatory consequence is the very real possibility that insurers will struggle to support future generations.

To help to manage some of these regulatory misgivings, there are strong levels of agreement among survey respondents that regulators should balance their concerns for policyholder protection with other socioeconomic objectives, such as promoting savings. More than three-quarters (78%) of respondents agree, while just 8% disagree. However, there was less conviction that policymakers should incorporate socioeconomic goals into regulators' remits; 48% agreed versus 13% who disagreed. Do insurers distrust politicians' ability to get this right? Or believe that although regulators should take a balanced view, a requirement to assess social impact should not be set in stone?

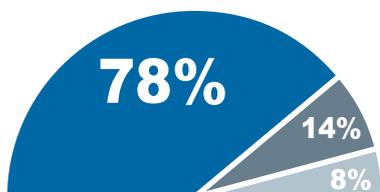
Mr Donelon of the NAIC says: "While regulators in the US are occasionally accused of social engineering, they are more

Chart 11

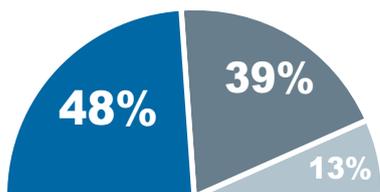
Q Do you agree or disagree with the following statements?

(% respondents)

● Agree ● Neither agree/nor disagree ● Disagree



Regulators should balance their concerns for policyholder protection with other socioeconomic objectives, such as promoting savings



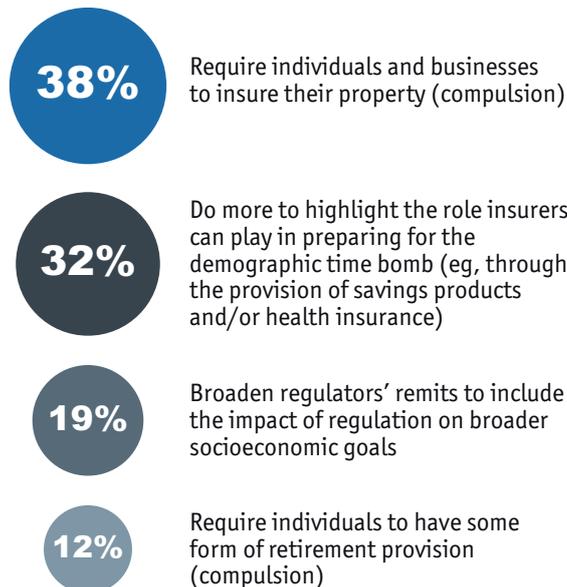
Policymakers should incorporate socioeconomic goals into regulators' remits

Source: Economist Intelligence Unit.

Chart 12

Q What should be the top priority for national policymakers in shaping the role of the insurance industry?

(% respondents)



Source: Economist Intelligence Unit.

concerned with their primary regulatory mission to make sure that insurers have sufficient capital at their disposal to honour the promises they have made to their policyholders and claimants."

The ACLI's Mr Brostoff adds: "It is not the role of regulation to drive a social agenda. The direction of society is determined by voluntary interactions among a free people and by policy choices enacted by the elected representatives of the people. Regulation should implement the public policy choices made by elected representatives and the marketplace decisions freely made by consumers. Anything beyond that is regulatory overreach."

When looking at the top priority for national policymakers in shaping the role of the insurance industry, nearly two-fifths (39%) of insurers say that it should be compulsory for individuals and businesses to insure their property. One in three would like to see policymakers promote the role that insurers can play in alleviating the impact of the demographic "time bomb".

5 Confronting climate change

Natural disasters cost insurers across the world US\$65bn in 2012, with estimated insured losses from the US Superstorm Sandy accounting for as much as US\$25bn alone. Insurers play a critical role in supporting businesses and individuals after such events, but also in tackling the probable causes of disasters before they occur.

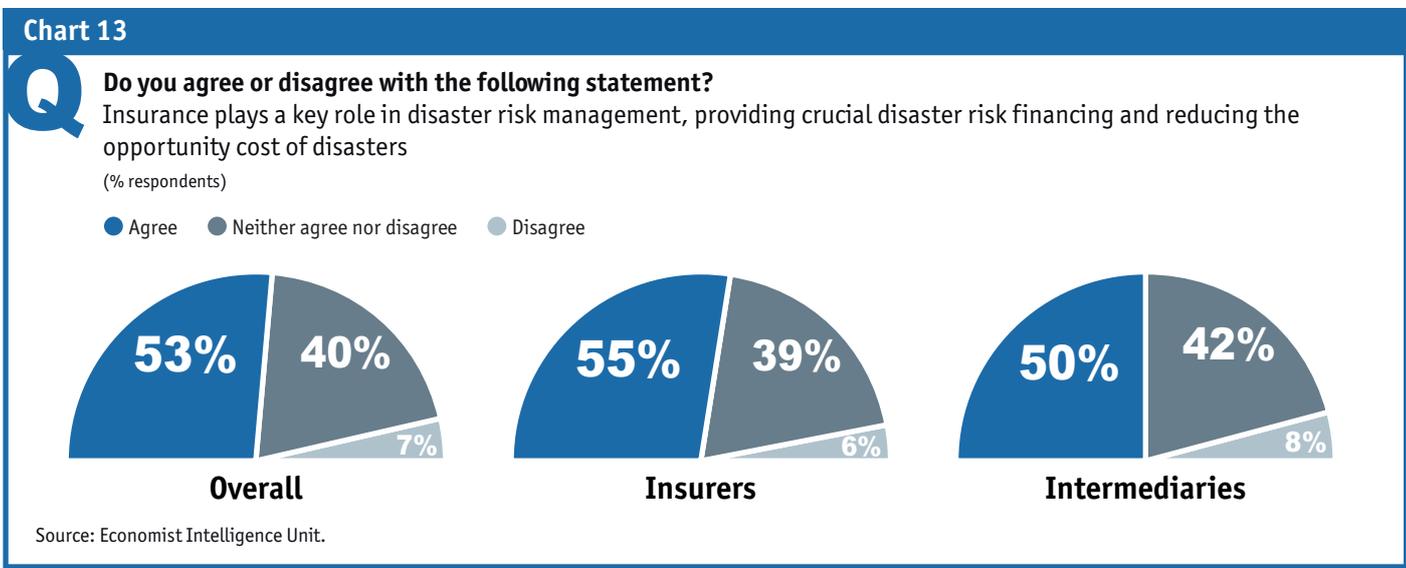
More than one-quarter (27%) of respondents say that climate change is one of the top three issues affecting non-life insurers, reflecting the growing economic impact of associated natural disasters.

More than one-half (53%) believe that the industry plays an important role in disaster risk management, providing crucial disaster risk financing and reducing the opportunity cost of disasters (only 7% disagree). Intermediaries

are less convinced, however, with one-half in agreement, compared with 55% of insurers.

Insurance Europe’s Mr Jones says: “Natural catastrophes represent a big issue for the insurance industry, particularly for reinsurers that take the brunt of the extreme weather conditions worldwide. Insurers and reinsurers aim to offer policies that are sufficient to cover potential claims, but the increasing severity of natural catastrophe damages, due to both socioeconomic reasons and climate change, can pose difficulty in offering sufficient cover.”

Following the March 2011 Japanese earthquake and tsunami, which is estimated to have cost insurers US\$310bn, Takashi Okuma, general manager in the international department of a Japanese trade body, the General Insurance



Association of Japan (GIAJ), says that insurers' responses to the disaster "reaffirmed the value of general insurance and the critical roles it plays".

In addition, Mr Okuma notes: "It also raised awareness of the effectiveness and robustness of the Residential Earthquake Insurance system in Japan, a private and public-sector risk-sharing scheme. Helping our customers in times of emergency also allowed us to reaffirm our confidence in our ability—backed by proper systems—to promptly pay out proper insurance claims and thereby fulfil our social and economic role."

In the UK, flooding has become one of the most expensive areas for insurers. The ABI says that insurers have paid around £5bn to households and businesses affected by flooding since 2000.

This figure looks set to rise as supposedly one-in-50-year flooding events might occur more frequently or have more significant financial consequences, given that population growth has forced migration to more susceptible areas, meaning that weather events have a greater adverse impact.

Mr Godfrey of L&G says: "This risks insurers being unable to provide cover at affordable prices. To date the issue has been contained under the principles [which allow flood insurance to be available widely without distorting the market] agreed between the industry and government. These expire in 2013 without a clear agreement as to the future arrangements. The issue has been compounded by government actions over many years [including] underinvestment in flood defences and building on flood plains."

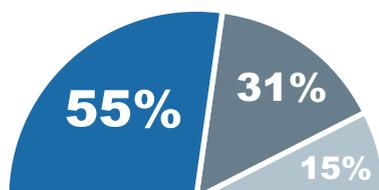
Chart 14



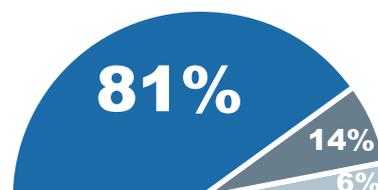
Do you agree or disagree with the following statements?

(% respondents)

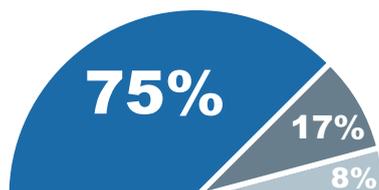
● Agree ● Neither agree nor disagree ● Disagree



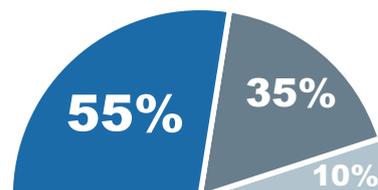
Without adequate data, re-insurers may pull back from providing catastrophe re-insurance in emerging markets



The scale of natural disasters in recent years has raised awareness of the benefits of insurance in mitigating the impact of such disasters



The recent increase in costly catastrophes will result in a hardening of premiums



The absence of data over the risk of catastrophes in emerging markets makes it difficult to properly assess the risks that insurers may be taking in these regions

Source: Economist Intelligence Unit.

Insurers are factoring in a growing number of consequences from climate change, including less obvious issues such as the impact on mental health, which in turn requires more data and modelling sophistication. As a consequence, policyholders may see their premiums rise or insurers could withdraw from certain markets entirely, particularly where statistics are limited.

Three-quarters of respondents agree that recent costly catastrophes will result in a hardening of premiums, while more than one-half (55%) believe that the absence of data over the risk of catastrophes in emerging markets makes it difficult to assess the risks properly.

The same number of respondents (55%) agree that without adequate data, reinsurers may withdraw from providing catastrophe reinsurance in emerging markets. By far the highest level of agreement is from Asia, where nearly two-thirds (61%) of those surveyed agree.

However, 81% of all respondents agree that the scale of natural disasters in recent years has raised awareness of the benefits of insurance in mitigating the impact of such extreme weather events, and this was particularly the case in Asia-Pacific, where just 5% of respondents disagree.

6 Evolving to meet changing needs

As society evolves, the risks that it needs to insure against change accordingly, creating both challenges and opportunities for insurers.

One-third of respondents say that rising longevity will be a challenge for life insurers in the period to 2030. At the same time, 19% of respondents say that fundamental changes to the structure of society will be a challenge for non-life insurers.

Irrespective of these challenges, three-quarters of those surveyed agree that the insurance

industry is keeping up with consumers' needs. Intermediaries are more likely to agree than insurers (78% and 72% respectively), and North American insurers are more confident than their European and Asian counterparts (76% versus 68% and 72% respectively).

However, this confidence in the ability to meet consumer needs is somewhat at odds with the adjustments that respondents say are being made by insurance companies as a reaction to changes in their industry.

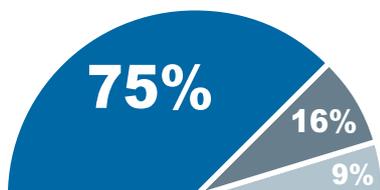
Chart 15



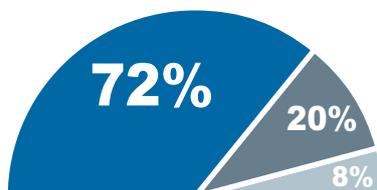
Do you agree or disagree with the following statement?

Insurers are keeping up with what consumers need (ie, protecting new technology, reflecting modern lifestyle choices)
(% respondents)

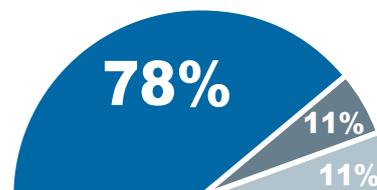
● Agree ● Neither agree nor disagree ● Disagree



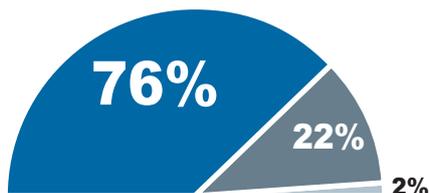
Overall



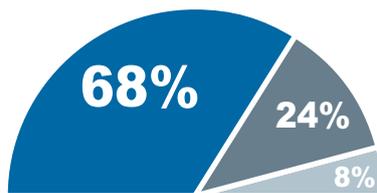
Insurers



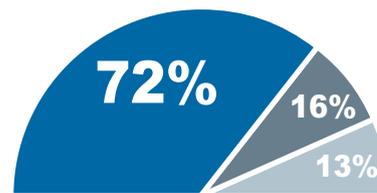
Intermediaries



North American insurers



European insurers



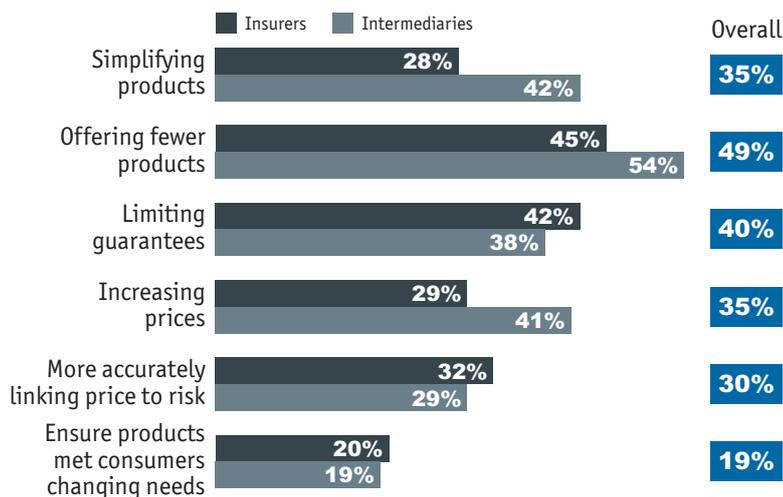
Asian insurers

Source: Economist Intelligence Unit.

Chart 16

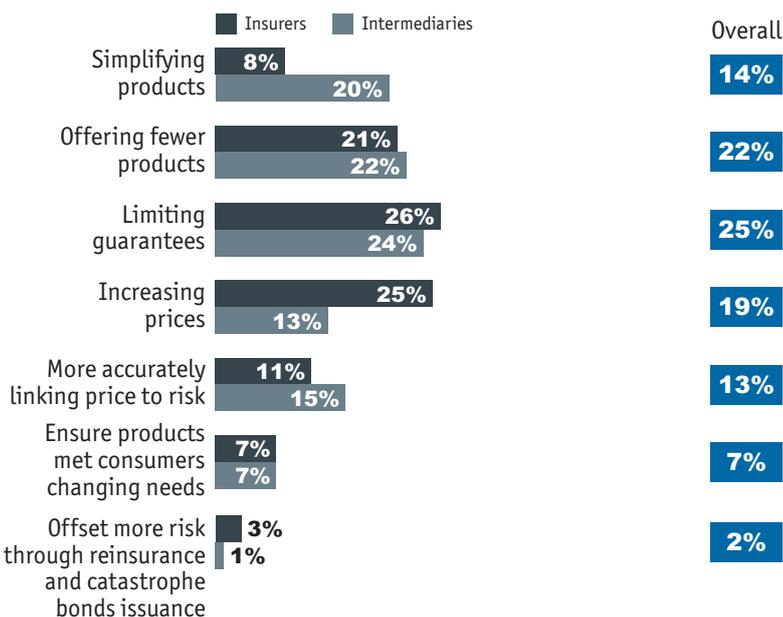
Q How ARE life insurers changing their product offerings in response to changes affecting their industry?

(% respondents)



How SHOULD life insurers change their product offerings in response to changes affecting their industry?

(% respondents)



Note. Figures do not add to 100% as respondents could select more than one option. Source: Economist Intelligence Unit.

Two-fifths of those surveyed say that life insurers are limiting guarantees, while nearly one-half (49%) believe that they are offering fewer products, with more than one-half (54%) of intermediaries saying that this is the case.

However, when asked how life insurers should change their products and businesses, less than one-quarter (22%) of respondents say that they should offer fewer products, compared with just one-quarter who suggest limiting guarantees.

The disparity suggests that insurers are having their hands forced by both challenging macroeconomic conditions and the impact of tough regulation. Were conditions more benign and regulation less severe, it may be the case that insurers would make fewer changes to their product ranges and business models.

The ACLI’s Mr Brostoff says: “Some [US] companies have reduced their offering of certain lines of insurance. The lines primarily affected include certain types of annuities and long-term care insurance.”

Such limitations to product ranges, particularly those which offer long-term guarantees such as annuities, might result in consumers being less able to rely on the private sector to underpin retirement funding and other long-term savings.

Two-fifths of respondents agree that if life insurers take the actions they should take—given existing regulation, tax legislation, accounting standards and shareholder pressure—the provision and effectiveness of private personal pensions will be harmed. Intermediaries are more likely than insurers to believe this to be true (43% versus 38%).

The survey also revealed a desire to drive out short-termism. One-half of respondents agree that regulation and accounting standards in their own country encourage short-term thinking by insurers, while more than one-half (54%) believe that regulators and legislators are focusing on near-term stability at the expense of longer-term economic growth.

Both US and European regulators refute the suggestion that legislation drives short-termism. Mr Montalvo at the EIOPA claims that Solvency II promotes long-term thinking, while the NAIC’s Mr Donelon says: “Regulators generally

believe it is stockholder demands for profitable returns that drive short-term thinking in the insurance industry.”

However, more than one-half (56%) of respondents agree and only 7% disagree that, because policymakers are typically elected for short terms, there should be more crossparty or constituency groups of policymakers that can examine the challenges and solutions of issues such as savings and pensions over a long-term horizon.

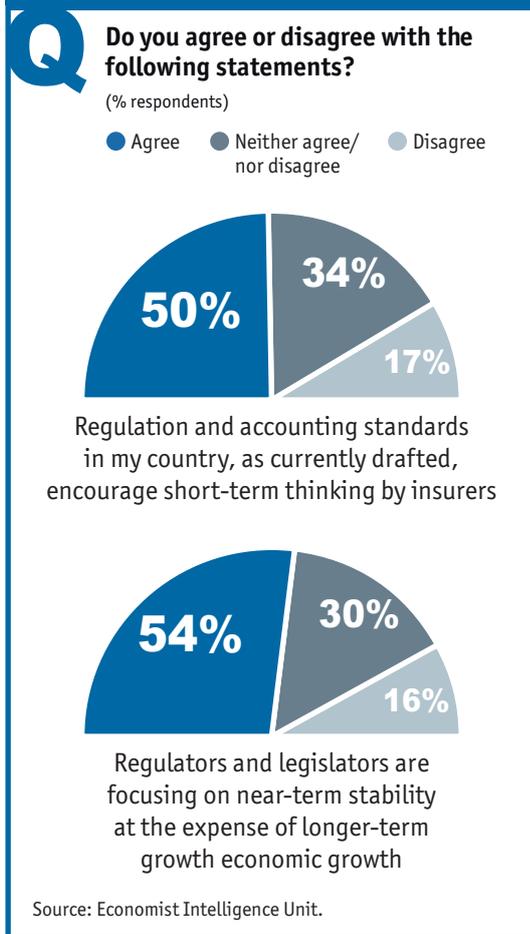
The UN Principles for Sustainable Insurance, which came into force in June 2012, represent a step to promote global best-practice standards for the industry and have been generally well received. Yet there remains scope for more collaboration between regulators, trade bodies and the insurance companies themselves.

For the non-life insurance and reinsurance sector, more than two-fifths (43%) of respondents say that they are increasing prices, with European insurers most likely to note that they are doing this (52%). Almost one-half (46%) of intermediaries say that insurers are increasing prices, compared with 39% of insurers. Looking at how non-life and reinsurers should change their products, nearly one-quarter (23%) of respondents believe that there should be price increases, while 22% favour limiting guarantees.

Again, as with the life insurance sector, these results suggest that non-life insurers are being driven to change their product ranges in ways they may not have done if it were not for regulatory pressure and economic uncertainty.

Mr Jones of Insurance Europe says: “When regulators increase capital requirements it has an impact on our policyholders. This is because our shareholders demand a certain return on investment and capital has to be funded by shareholders, so more capital means shareholders will get a lower return. Consequently, when capital requirements increase, we either have to stop selling certain

Chart 17



products if we can’t meet minimum returns, pass more risk back to the customer, increase the price or a combination of those. It is vital to ensure that high capital is really needed, because there are areas where the regulations overestimate the true risk. Second, a balance is required between protecting the consumer by raising capital requirements and guaranteeing the consumer a wide choice of products.”

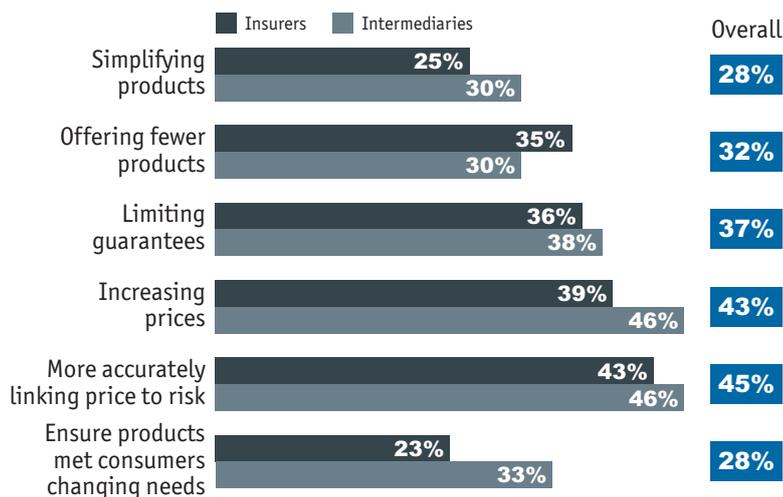
Insurers are clearly concerned that the regulatory demand to hold more capital to protect policyholders could have the perverse consequence of actually driving up prices and pushing some customers out of the insurance market.

However, Mr Montalvo at the EIOPA says that additional capital requirements are justified.

Chart 18

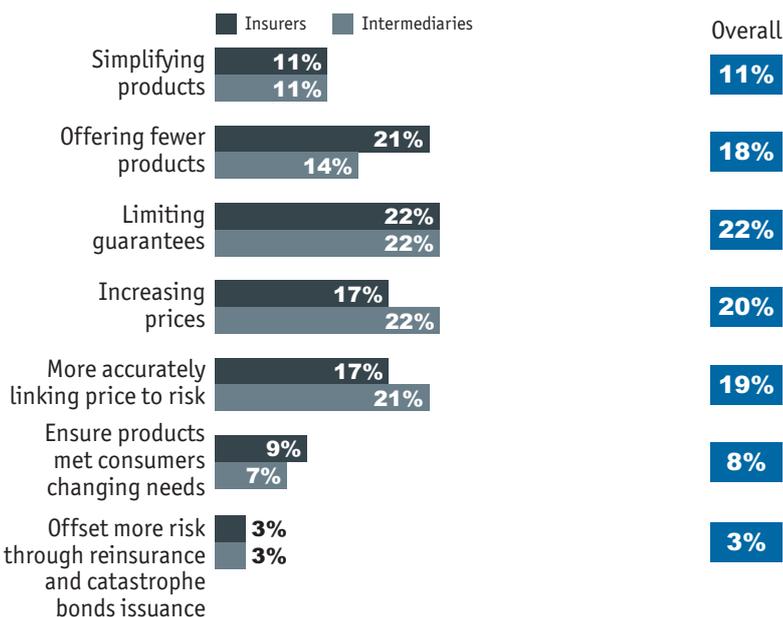
Q How ARE non-life insurers and reinsurers changing their product offerings in response to changes affecting their industry?

(% respondents)



How SHOULD non-life insurers and reinsurers change their product offerings in response to changes affecting their industry?

(% respondents)



Note. Figures do not add to 100% as respondents could select more than one option. Source: Economist Intelligence Unit.

brings, namely enhancing risk management and facilitating better decision-making. And it is my strong belief that benefits outweigh costs.”

He adds: “EIOPA is aware that companies have publicly indicated they are considering leaving Europe, but we are not aware of particular evidence that this is the case. Europe is and will remain a major and attractive market for insurers. Risk-based supervision, of which Solvency II is a reference, is increasingly recognised as a global benchmark in terms of an effective insurance regulatory system and many major countries, such as Switzerland, South Africa and Mexico, have already or are in the process of developing similar regimes.”

It would appear that the insurance industry might challenge that view, as 45% of respondents believe that organisations will relocate to less-regulated jurisdictions.

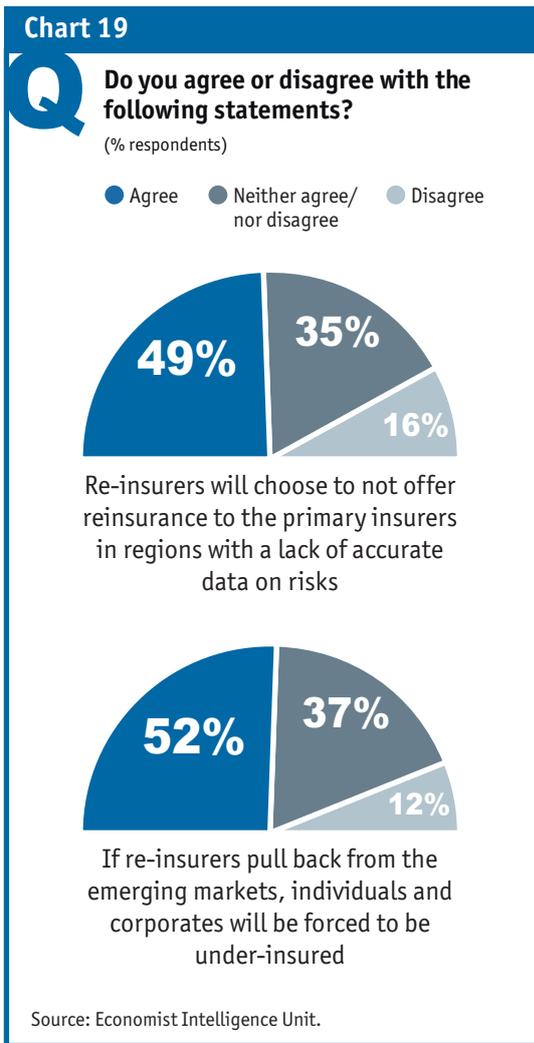
The survey also reveals another challenge that could undermine insurers’ ability to meet consumer needs—and to support economic growth. Specifically, where there is a lack of data on risk in emerging markets, nearly one-half (49%) of respondents feel that it is likely that reinsurers will choose not to offer reinsurance to the primary insurers in those regions, and 52% believe that this will mean that individuals and corporates in emerging markets are left underinsured.

Insurers’ potential unwillingness to participate in emerging markets has significant ramifications for the insurance industry itself as well as the global economy.

By focusing on developed economies, with their saturated insurance markets and slow pace of economic growth, insurers will fail to capitalise on the substantial gains in market share to be made in emerging economies, and as a result total global insurance penetration will not grow.

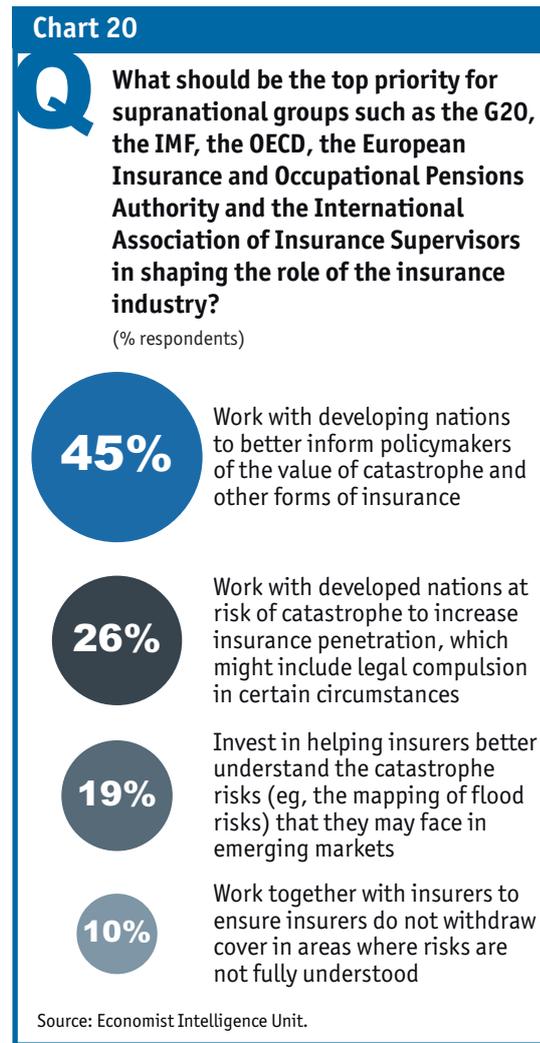
Also, with most developed economies expanding slowly—or not at all—the global economy is

“EIOPA undertakes an impact assessment for all the regulations that it issued and therefore aims to ensure that the benefits outweigh the costs,” he says. “This means that any additional costs to insurers or customers have to be balanced against the benefits that the new framework



reliant on emerging markets to drive growth. If insurers are unwilling to support these economies by providing consumers and businesses with the insurance they need to protect themselves against risk, these economies will not be able to grow as quickly as they could.

Survey respondents recognise the need to support emerging economies. When considering the top priorities for the world’s supranational organisations—including the G20, the IMF, the OECD, the EIOPA and the International Association of Insurance Supervisors (IAIS)—in shaping the insurance industry, almost one-half (45%) of respondents say that they should work with developing countries to inform policymakers



better of the value of catastrophe and other forms of insurance.

When looking at the top priority for national policymakers in shaping the role of the insurance industry, nearly two-fifths (39%) of insurers say that it should be compulsory for individuals and businesses to insure their property.

Looking at non-life and reinsurers specifically, more than one-third (34%) of respondents say risk reduction (for example, through improving building codes) is the most important priority for supranationals and governments within the next five years. Over the longer term, 35% consider

financial protection, such as the creation of catastrophe risk insurance pools, the top priority in the period to 2030.

Mr Okuma of the GIAJ says: "Our current proposals include relaxing the scope of business for insurers and their subsidiaries, and allowing them to offer insurance-associated services, for example trust services regarding insurance claims and auxiliary business relating to disaster-prevention consulting; the easing of conditions for carrying out concerted activities in order to provide compensation for new types of risks promptly; and the allowance to establish a joint private-sector/government compensation framework to deal with large risks which exceed

the private sector's capacity. These proposals are aimed at responding to customer needs more flexibly."

Risk reduction remains important in the near term (over the next five years) as well as over the longer term for one-third of respondents, while risk identification, such as transparent hazard mapping, becomes less of an issue.

Despite concerns that insurers may withdraw from certain regions that lack adequate risk data, there is relatively low demand (19%) for supranational groups to work with insurers to maintain cover where risks are not fully understood. ■

Conclusion

Insurance companies remain an important force for good both economically and in terms of societal impact, yet there is a pervasive sense that this may be undermined by legislation.

The insurance industry is clear that heavy-handed regulation, onerous reporting regimes and short-term thinking could weaken an insurer's ability and desire to take on individuals' and institutions' risk at affordable rates.

Additionally, there may be less innovation and product development.

Insurance Europe's Mr Jones says: "If you have an enormous number of rules, you stifle innovation and development. You have to be sparing and careful [with regulation]."

At the same time, the insurance industry is grappling with the impact of natural disasters such as Superstorm Sandy, which are having ever-larger financial consequences as populations expand in at-risk areas, while an ageing population is becoming more reliant on the private sector for financial support, as many governments reduce or withdraw from state-funded provision.

It is clear that insurers must maintain dialogue with regulators if they are to ensure that legislation does not impinge excessively on their businesses, but at the same time they could do more to communicate with their customer-base in order to help to limit risk.

Mr Donelon at the NAIC says: "Insurers need to actively promote sound risk management and serve as an information source regarding cost-effective loss mitigation steps people and businesses can take to reduce the risks of future loss."

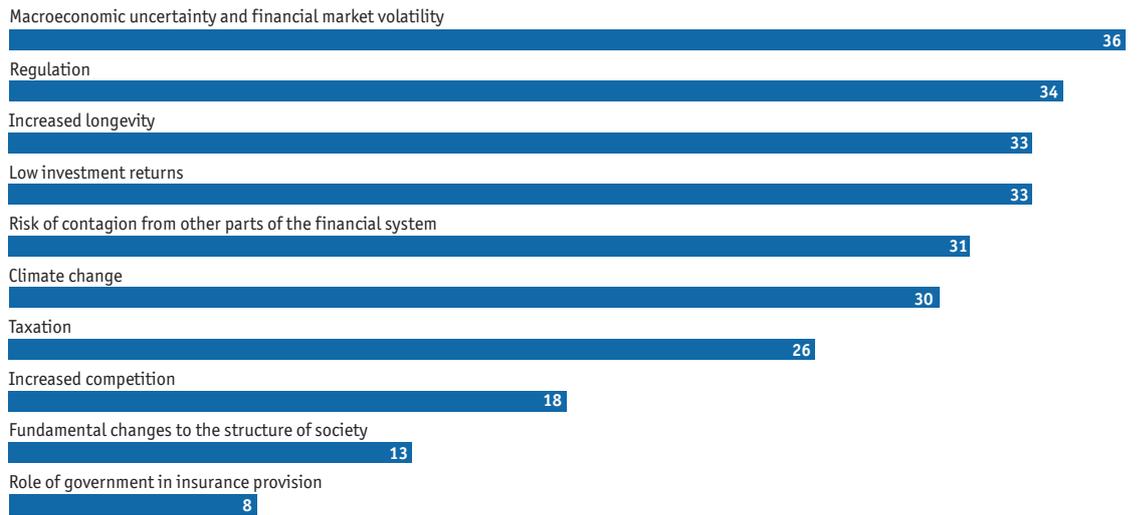
Looking to the future, collaboration and communication between insurers, regulators and their customer base will be key in maintaining the insurance industry as a pivotal player in promoting positive societal and economic behaviour. Failure to do so will erode insurers' ability to deliver against their *raison d'être*, and this will have serious ramifications not just for the industry itself, but also for future generations. The challenge is to prioritise the long term over the short term through collective action.

Appendix: Survey results

What do you believe are the factors most likely to affect the insurance industry in the years to 2030? Select up to three.

- Life insurers

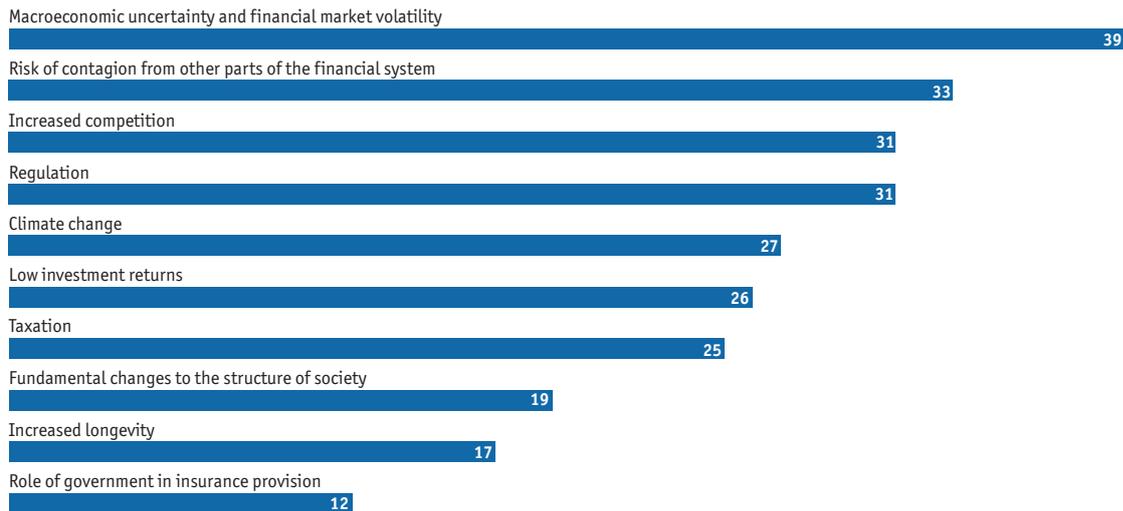
(% respondents)



What do you believe are the factors most likely to affect the insurance industry in the years to 2030? Select up to three.

- Non-life & reinsurers

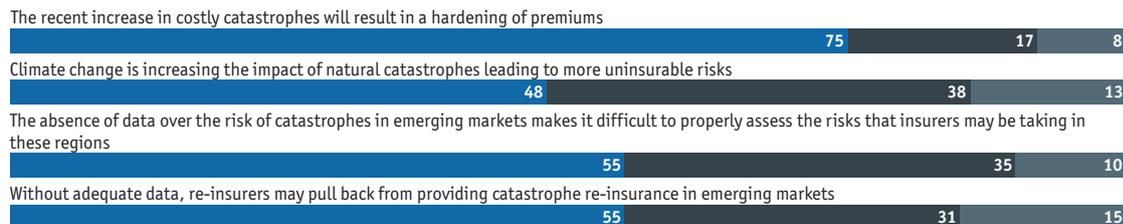
(% respondents)



Do you agree or disagree with the following statements? Rate on a scale of 1 to 3 where 1 is agree and 3 is disagree.

(% respondents)

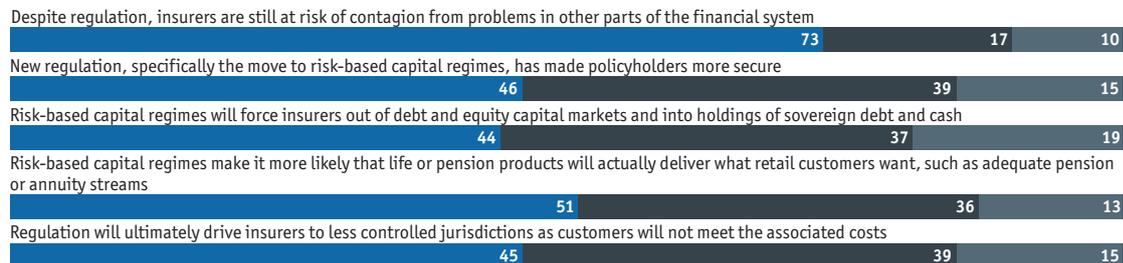
1 Agree 2 3 Disagree



Do you agree or disagree with the following statements? Rate on a scale of 1 to 3 where 1 is agree and 3 is disagree.

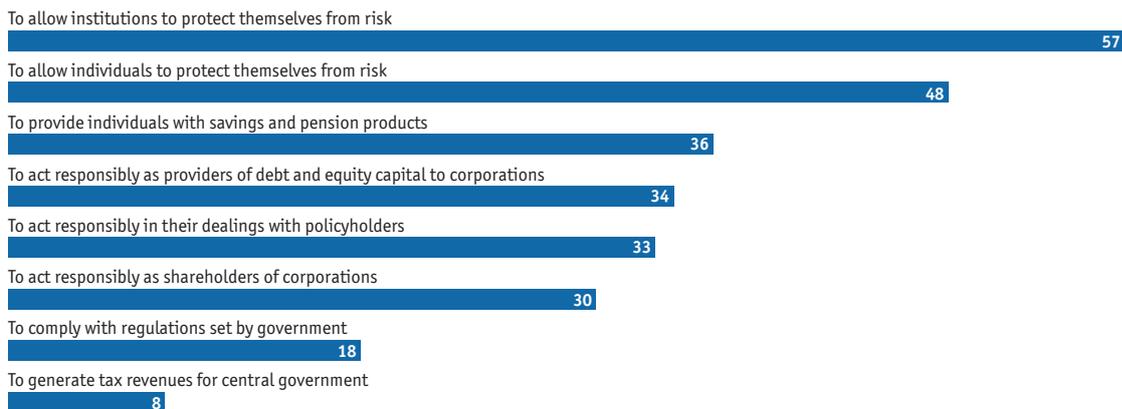
(% respondents)

1 Agree 2 3 Disagree



What are the most important roles the insurance industry plays in society? Select up to three.

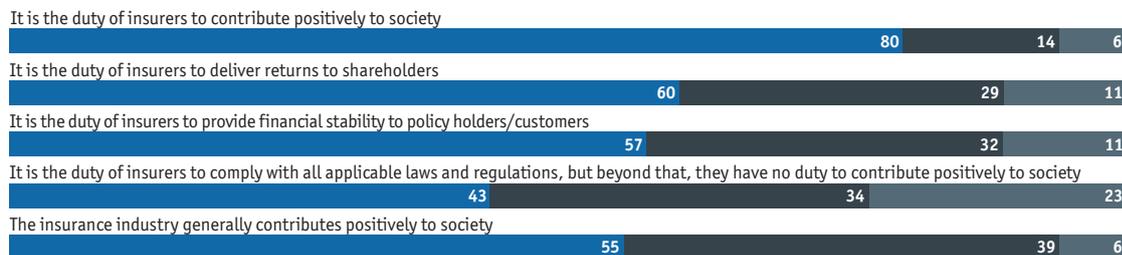
(% respondents)



Do you agree or disagree with the following statements? Rate on a scale of 1 to 3 where 1 is agree and 3 is disagree.

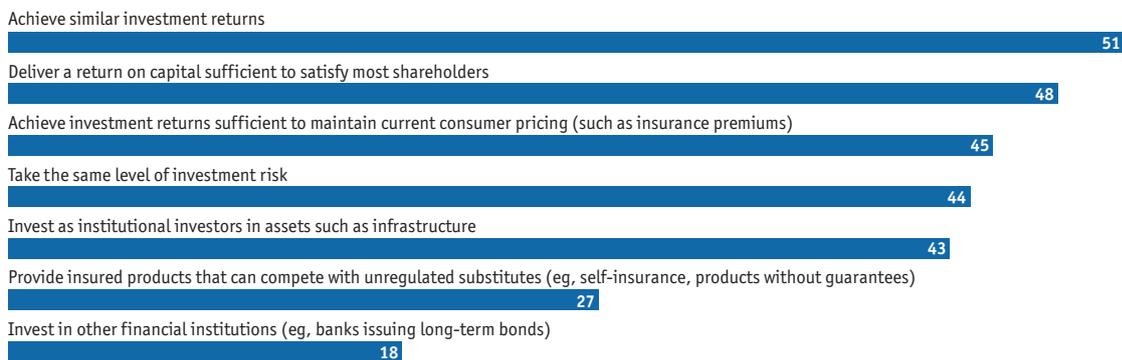
(% respondents)

1 Agree 2 3 Disagree



Will insurance regulation make it more difficult for insurers to do any of the following? Select all that apply.

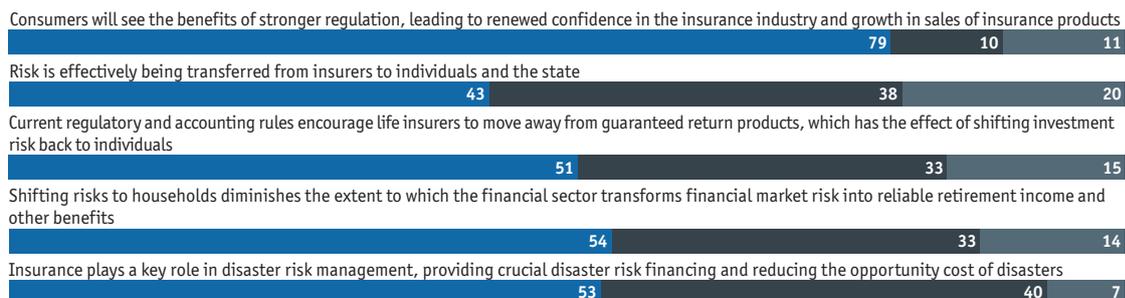
(% respondents)



Do you agree or disagree with the following statements? Rate on a scale of 1 to 3 where 1 is agree and 3 is disagree.

(% respondents)

■ 1 Agree ■ 2 ■ 3 Disagree

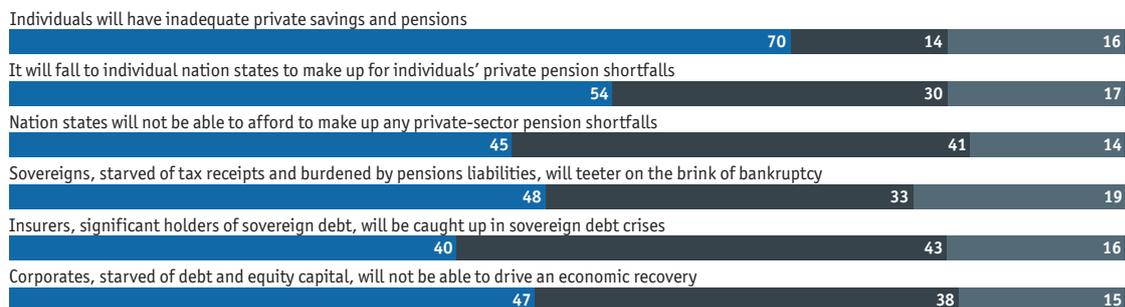


Do you agree or disagree with the following statements about the long-term impact of new insurance regulation?

Rate on a scale of 1 to 3 where 1 is agree and 3 is disagree.

(% respondents)

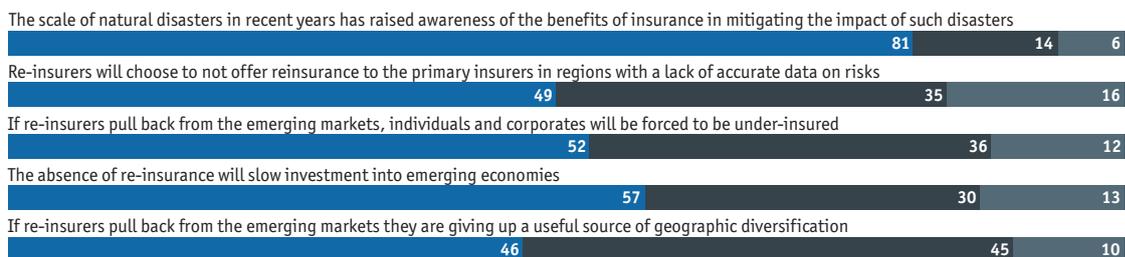
■ 1 Agree ■ 2 ■ 3 Disagree



Do you agree or disagree with the following statements? Rate on a scale of 1 to 3 where 1 is agree and 3 is disagree.

(% respondents)

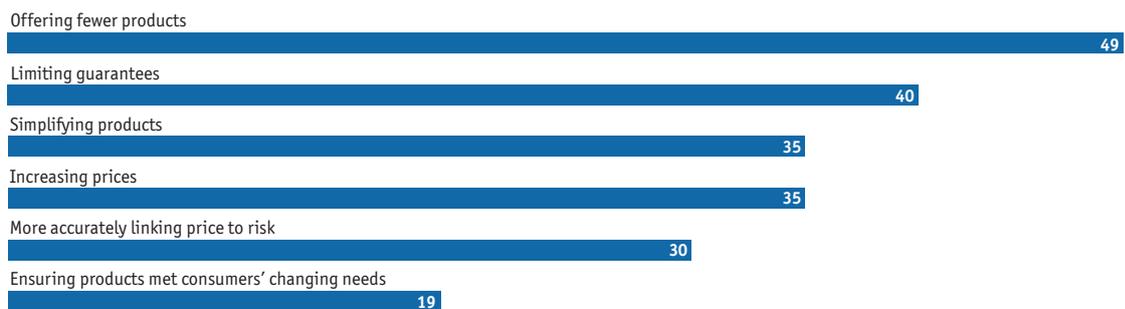
■ 1 Agree ■ 2 ■ 3 Disagree



How are insurers changing their product offerings in response to changes affecting their industry? Select up to three.

- Life insurers

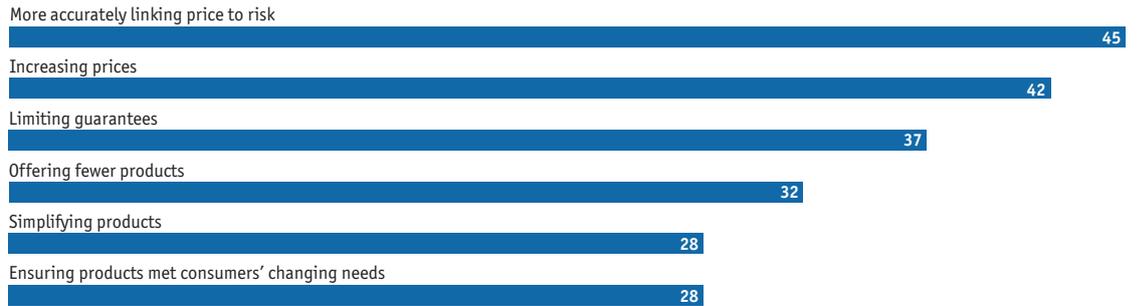
(% respondents)



How are insurers changing their product offerings in response to changes affecting their industry? Select up to three.

- Non-life insurers

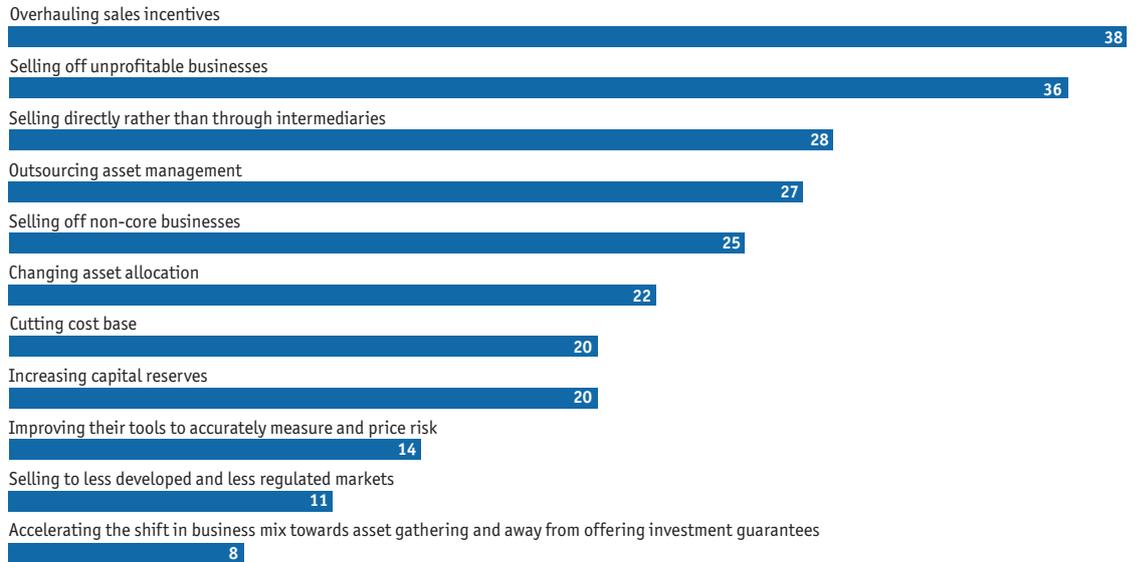
(% respondents)



How are insurers changing their businesses in response to changes affecting their industry? Select up to three.

- Life insurers

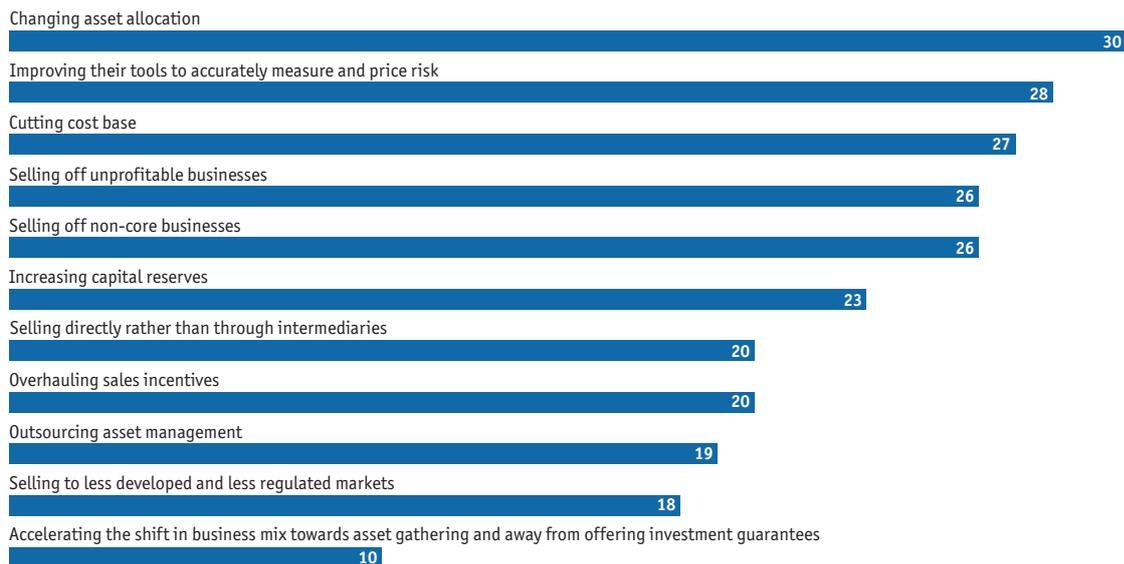
(% respondents)



How are insurers changing their businesses in response to changes affecting their industry? Select up to three.

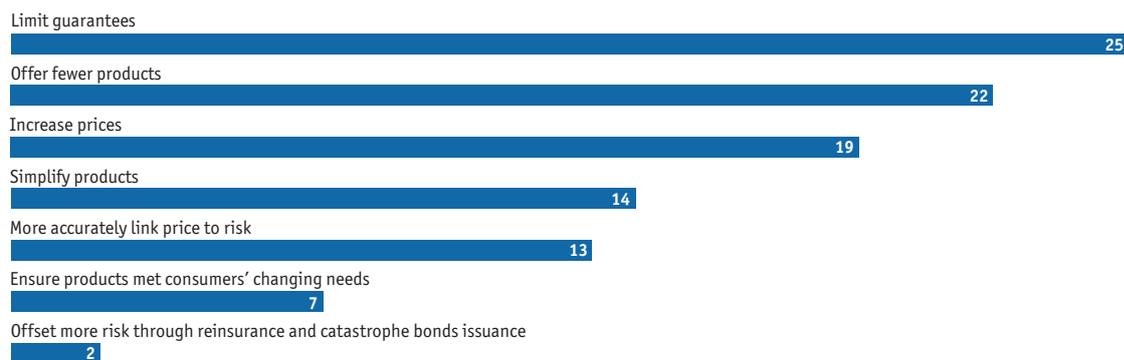
- Non-life insurers

(% respondents)



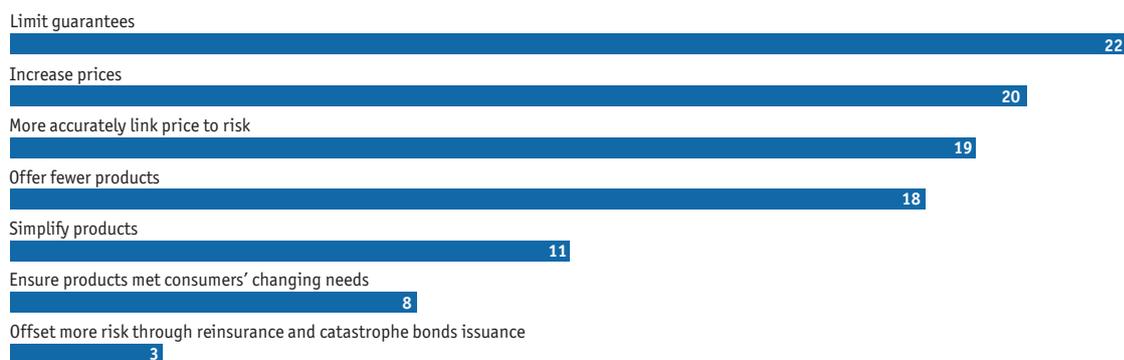
How should insurers change their product offerings in response to changes affecting their industry? - Life insurers

(% respondents)



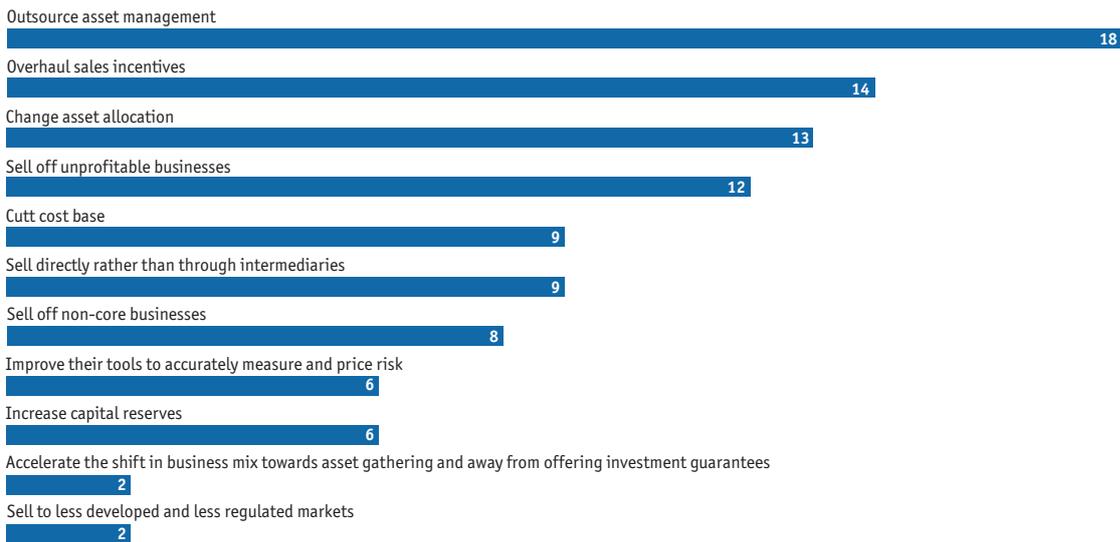
How should insurers change their product offerings in response to changes affecting their industry? - Non-life/re-insurers

(% respondents)



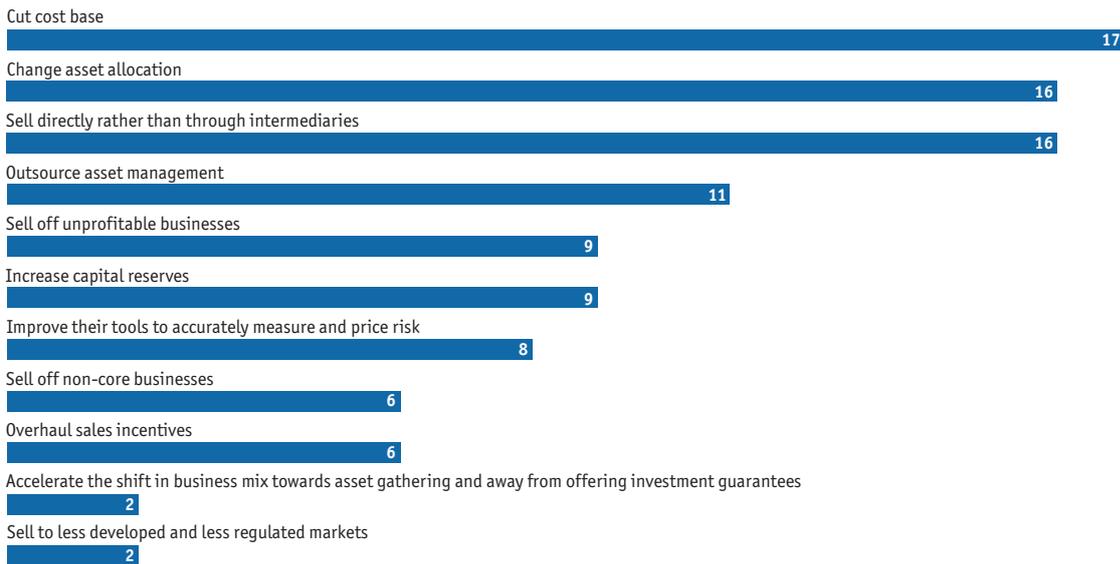
How should insurers change their businesses in response to changes affecting their industry? - Life insurers

(% respondents)



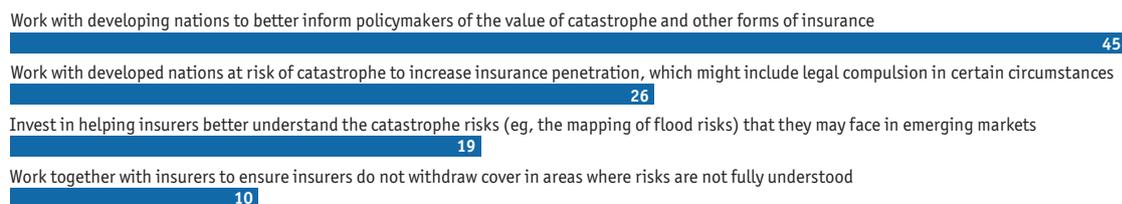
How should insurers change their businesses in response to changes affecting their industry? - Non-life/re-insurers

(% respondents)



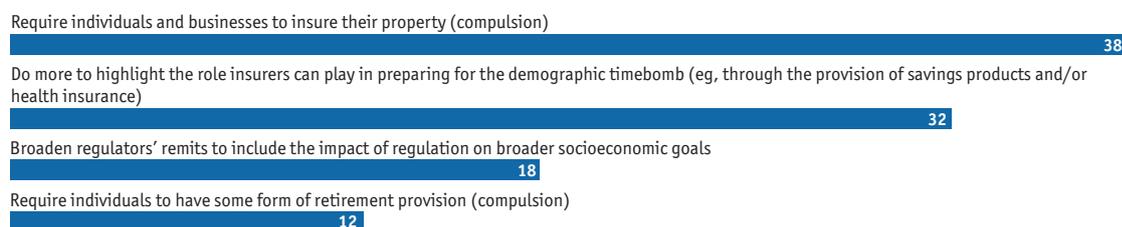
What should be the top priority for supranational groups such as the G20, the IMF, the OECD, the European Insurance and Occupational Pensions Authority and the International Association of Insurance Supervisors in shaping the role of the insurance industry?

(% respondents)



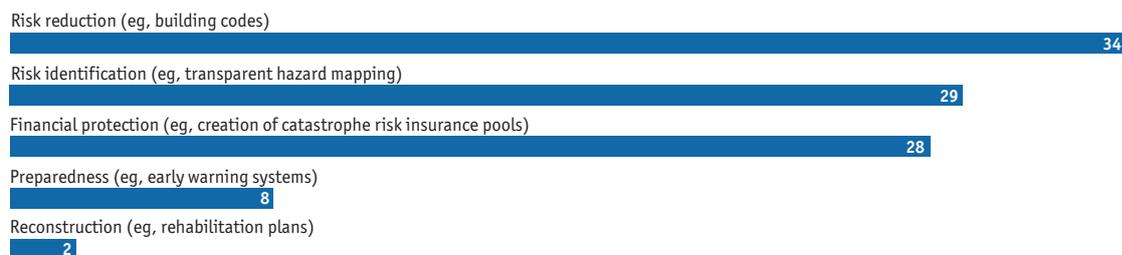
What should be the top priority for national policymakers in shaping the role of the insurance industry?

(% respondents)



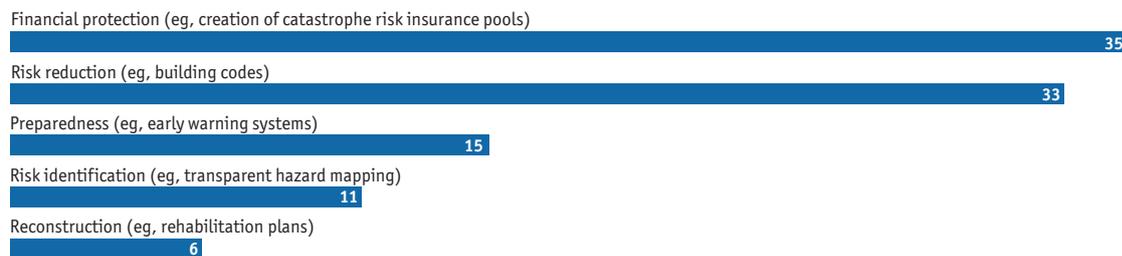
What is the most important priority where the OECD, the World Bank and nation states should focus their efforts to improve non-life/reinsurance provision? - In the near term (within next 5 years)

(% respondents)



What is the most important priority where the OECD, the World Bank and nation states should focus their efforts to improve non-life/reinsurance provision? - Longer term (to 2030)

(% respondents)



Do you agree or disagree with the following statements? Rate on a scale of 1 to 3 where 1 is agree and 3 is disagree.

(% respondents)

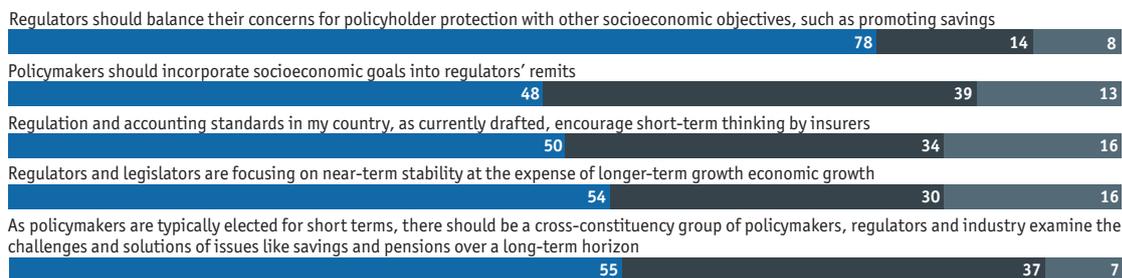
■ 1 Agree ■ 2 ■ 3 Disagree



Do you agree or disagree with the following statements? Rate on a scale of 1 to 3 where 1 is agree and 3 is disagree.

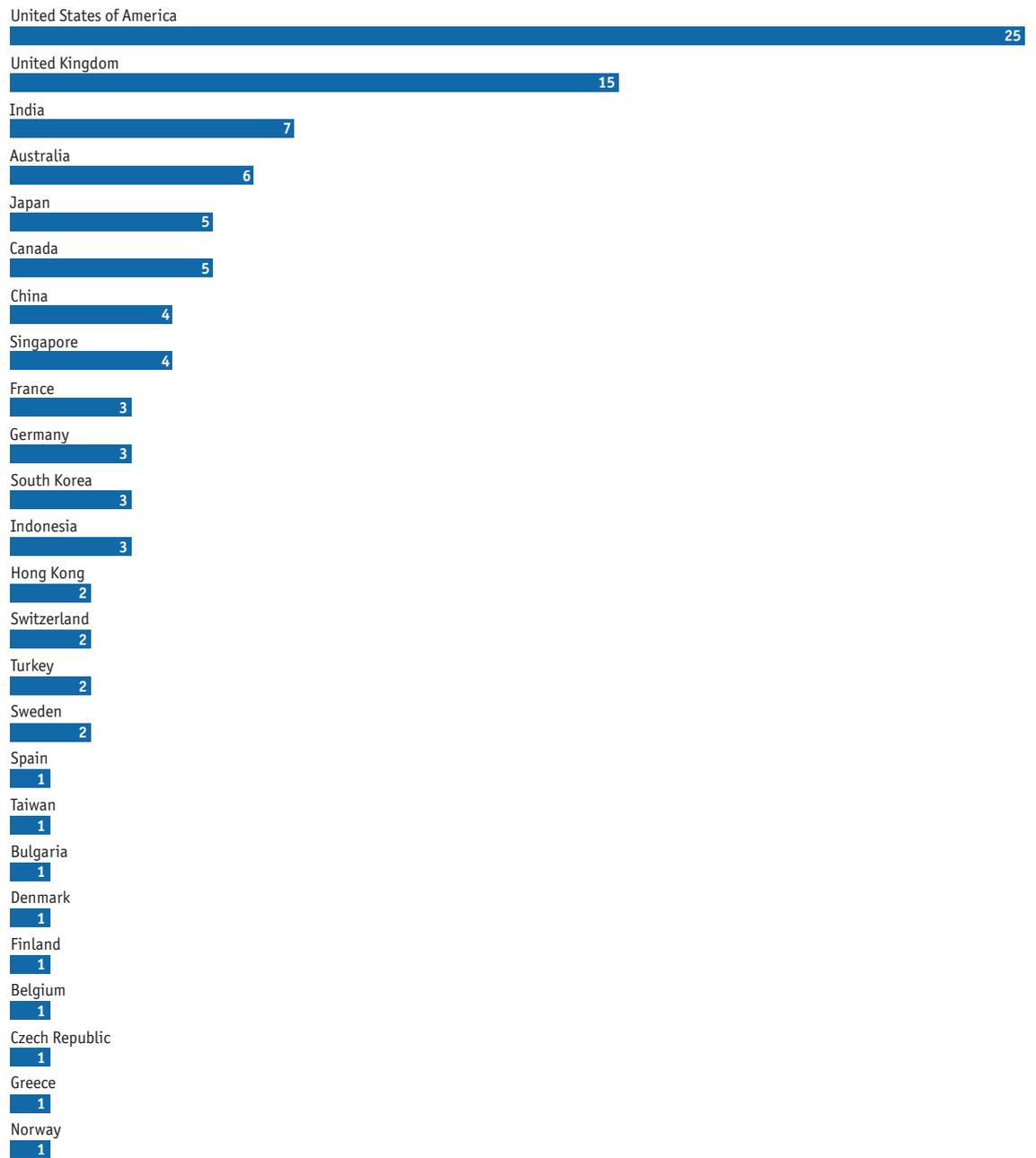
(% respondents)

■ 1 Agree ■ 2 ■ 3 Disagree



In which country are you personally located?

(% respondents)



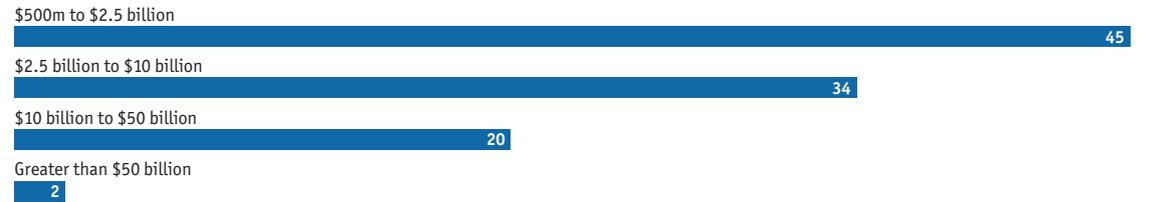
In which region are you personally located?

(% respondents)



If you are an insurer, what are your organisation's gross written premiums (GWP)?

(% respondents)



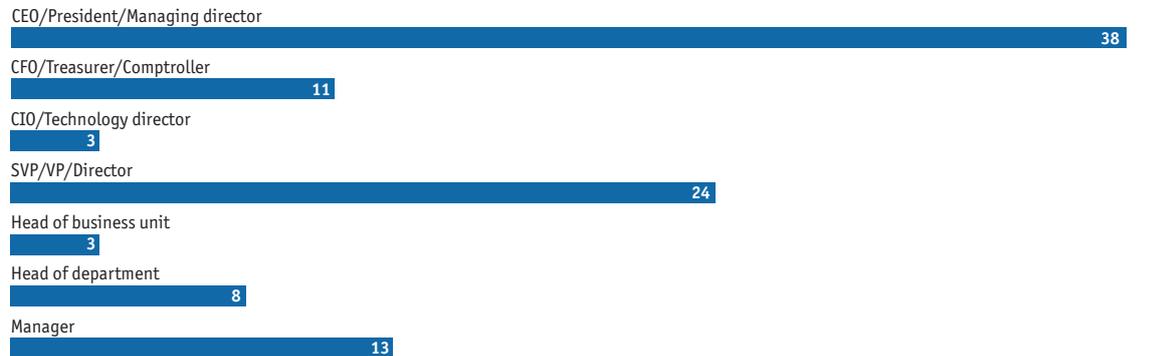
If you are an intermediary, what are your organisation's global annual revenues?

(% respondents)



Which of the following best describes your job title?

(% respondents)



What is your main business?

(% respondents)



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